

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF WOOD CREEK WATER)
DISTRICT, OF LAUREL COUNTY, KENTUCKY,)
FOR APPROVAL OF CONSTRUCTION,) CASE NO. 9594
FINANCING, AND INCREASED WATER RATES)

O R D E R

Wood Creek Water District ("Wood Creek") by application filed on May 28, 1986, is seeking approval of adjustments to its water service rates, authorization to construct a \$1,271,200 waterworks improvement project and approval of its plan of financing for this project. The project funding includes a \$600,000 loan from the Farmers Home Administration ("FmHA") and a \$671,200 Community Development Block Grant ("CDBG") administered by the Department of Local Government. The FmHA loan would be secured by waterworks revenue bonds maturing over a 40-year period at an interest rate of 8 5/8 percent per annum.

Drawings and specifications for the proposed improvements by Robert G. Campbell & Associates, Inc., of Knoxville, Tennessee, ("Engineer") have been approved by the Division of Water of the Natural Resources and Environmental Protection Cabinet.

The Commission's November 26, 1986, Order made a Staff Report of November 14, 1986, part of the record in this case. The Staff Report questioned the need for the proposed construction and the benefits to be received by Wood Creek's customers.

A hearing was held in the offices of the Public Service Commission, in Frankfort, Kentucky, on December 10, 1986. There were no intervenors and no protests were entered.

COMMENTARY ON CONSTRUCTION

This Commission is very much aware of its responsibility to review proposed construction projects for technological and economic adequacy. The Commission has raised the issue of the appropriateness of proposed utility construction during the review of previous cases. Indeed, in Wood Creek's most recent construction case (C.N. 8905) the question of whether the proposed construction would be "used and useful" was a predominant issue in the Commission's review. The language of the final Order in C.N. 8905 instructs Wood Creek that it "can anticipate that the Commission will review future construction projects for demonstrated practicality and cost-effectiveness."

In its current application before the Commission, Wood Creek is seeking permission to construct approximately 4.6 miles of 20-inch transmission pipeline at a cost of nearly \$1.3 million. As part of its technical review of the application, the Commission's engineering staff prepared a report which raised several questions concerning both the practicality and the cost-effectiveness of the proposed construction. This Staff Report was distributed to the parties of record and made a part of the record in the case. In essence, the Staff Report challenged Wood Creek's proposal to spend over a million dollars on a project for which there was no immediate benefit and only speculative future benefit.

According to the Staff Report the proposed construction of the 20-inch transmission main is intended to move more water to the southern portion of Wood Creek's system and to the West Laurel Water Association ("West Laurel"). However, the Report states that it is doubtful that even if more water were available from Wood Creek that West Laurel could use it without major improvements to its existing water distribution system. The Staff Report further comments that the proposed 20-inch transmission main is not hydraulically compatible with Wood Creek's existing pumps and could without corrective action, damage the pumps themselves. The Report concluded that Wood Creek had failed to demonstrate what, if any, benefit the proposed construction of the 20-inch pipeline will provide to the customers of Wood Creek.

During the public hearing held December 10, 1986, Wood Creek presented testimony and additional information to refute the conclusions and recommendations contained in the Staff Report and to demonstrate the need for its proposed construction. The Commission has reviewed the evidence presented by Wood Creek and does not find it to be persuasive. The Commission is concerned that Wood Creek plans to spend several millions of dollars over the next few years based primarily on speculations relative to growth. Central to Wood Creek's proposed construction program is the expansion of its existing water treatment plant at Wood Creek Lake. The Regional Water Plant Study prepared for the Cumberland Valley Area Development District in 1983 by GRW Engineers, Inc., presents a different construction program for serving the future water supply needs of Laurel County than the one currently

contemplated by Wood Creek. It does not appear that Wood Creek has investigated the cost-effectiveness of this, or any, alternative construction programs.

Before the Commission can agree to burden the customers of Wood Creek with a huge long-term debt and to permit the assignment of a significant amount of tax revenues to any proposed construction, it must be convinced that public convenience and necessity require it. The construction of unnecessary water system improvements would not only burden Wood Creek's customers with a higher water rate but could actually make it more difficult to obtain funds to extend water service to other areas in Laurel County. This Commission is committed to the extension of water service to as many of the Commonwealth's rural citizens as practical. The Commission is of the opinion that this can best be accomplished by effective planning and efficient use of available resources. Prior to embarking upon construction of the scope, magnitude, and expense of that proposed, Wood Creek should conduct a competent comprehensive analysis of the situation. In order to demonstrate both the practicality and cost-effectiveness of any proposed course of action, such an analysis would be expected to review all water suppliers and purveyors in the area and their interrelation with each other. A comprehensive review would also evaluate land use patterns, current customer demands, and the adequacy of existing water distribution systems. An acceptable planning study would make a concerted attempt to forecast population trends, land use patterns, commercial and industrial development, and their effect on future water use. Such a report

would identify and quantify the specific improvements to distribution, transmission, and treatment facilities needed to accommodate projected water usage projections. Once the appropriate course of action has been identified, a time frame for implementation should be outlined. The outline should set out the orderly progression of financing and construction of the selected improvements as well as subsequent review points and alternative courses of action should future events dictate. Any long range project should carry with it a firm commitment of financial support from funding agencies and acceptance from governmental review agencies. This Commission is of the opinion that Wood Creek has failed to conduct such a comprehensive analysis of its water system and as a result has failed to demonstrate the appropriateness of the project proposed in this case.

REVENUE REQUIREMENTS

In its application Wood Creek requested an increase in revenues of \$86,359. The report of the Commission staff dated September 16, 1986, recommended that Wood Creek be granted an increase of \$38,528 if the Commission did not approve the proposed construction. The construction has been denied; however, circumstances now exist which do not permit the Commission to directly follow the recommendations of the staff report.

The September 16, 1986, staff report's recommendation was based on the Commission's long-standing practice of excluding depreciation expense on contributed property from the calculation of revenue requirements. Since the date of that report, the Supreme Court of Kentucky has rendered a decision in Public

Service Commission v. Dewitt Water District, 86-SC-342-DG, and East Clark Water District and Warren County Water District v. Public Service Commission, 86-SC-362-DG, which requires the Commission to consider depreciation expense on contributed property as an expense for rate-making purposes. In the case of Wood Creek such consideration would result in a significant increase in revenue requirements. In fact, Wood Creek's revenue requirement would be greater than the amount of revenue requested in conjunction with the construction project which has herein been denied.¹ However, the Commission has no knowledge of whether Wood Creek desires such an increase or what its preferred rate design would be, without the additional construction. Therefore, in this Order, the Commission will grant no increase in rates.

Wood Creek, pursuant to KRS 278.400, has the opportunity to petition for rehearing. As part of any such petition Wood Creek

¹	Average Annual Debt Service on Existing Plant	\$192,640
	Plus:	
	20% Debt Service Coverage	38,528
	Adjusted Operating Expenses (Including Full Depreciation on Existing Plant)	<u>692,959</u>
	Wood Creek Revenue Requirement	\$924,127
	Less:	
	Normalized Revenues - Staff Report	
	Operating Revenues	765,056
	Other Income	<u>65,474</u>
	Required Increase	\$ 93,597
	Less:	
	Requested Increase	<u>86,359</u>
	Revenue Deficiency	\$ 7,238

can make known its preferences in these matters which the Commission can then address in a manner consistent with the recent decision of the Supreme Court of Kentucky.

FINDINGS AND ORDERS

The Commission, after consideration of the evidence of record, and being advised, is of the opinion and finds that:

1. Public convenience and necessity do not require that the construction proposed in the application be performed, and a certificate of public convenience and necessity should be denied.

2. Due to the denial of a certificate of public convenience and necessity, the financing secured by Wood Creek for this project will not be needed. Wood Creek's financing plan should, therefore, not be approved.

3. Due to the denial of a certificate of public convenience and necessity for the proposed construction project and the implications of the decision of the Kentucky Supreme Court regarding the issue of depreciation expense, no increase in rates should be approved at this time.

IT IS THEREFORE ORDERED that:

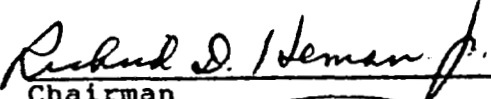
1. Wood Creek be and it hereby is denied a certificate of public convenience and necessity for the proposed construction project as set forth in the drawings and specifications of record herein.

2. Wood Creek's financing plan consisting of an FmHA loan of \$600,000 and \$671,200 in CDBG funds be and it hereby is denied.

3. Wood Creek's proposed increase in rates be and it hereby is denied without prejudice.

Done at Frankfort, Kentucky, this 23rd day of December, 1986.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Executive Director